

**Testimony of
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**Before the
Communications Subcommittee
Senate Commerce, Science and Transportation Committee
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**“The Future of Universal Service:
Ensuring the Sufficiency and Stability of the Fund”**

My name is Billy Jack Gregg and I am the Director of the West Virginia Consumer Advocate Division. My office is charged with the responsibility of representing West Virginia utility ratepayers in state and federal proceedings which may affect rates for electricity, gas, telephone and water service. My office is also a member of the National Association of State Consumer Advocates (NASUCA), an organization of 42 state utility consumer advocate offices from 39 states and the District of Columbia, charged by their respective state statutes with representing utility consumers before state and federal utility commissions and before state and federal courts. I am a former member of the Board of Directors of the Universal Service Administrative Company (USAC) and currently serve on the Federal-State Joint Board on Universal Service. I greatly appreciate the opportunity to testify at this legislative hearing on the future sufficiency and stability of the Federal Universal Service Fund (USF).

I. Introduction

First, I would like to commend Chairman Inouye, the members of the Subcommittee, and your staffs for conducting this review of the operation of the universal service fund at this time. I and other members of NASUCA truly appreciate your continuing efforts to seek out the views of consumers and consumer representatives. We look forward to continuing to work with you in developing telecommunications policies and legislation that benefit all consumers and the nation as a whole.

II. Background

The most important issue facing the Federal Universal Service Fund is its long-term sustainability, that is, ensuring that the USF is sufficient, predictable and affordable for all parties involved: fund recipients, telecommunications providers and consumers. Before I address the current problems facing the USF, I believe it is appropriate to review the achievements of the USF since the passage of the Telecommunications Act of 1996 (the Act).

Section 254 of the Act enshrined and expanded universal service principles which had been followed by the Federal Communications Commission for decades. Based upon the requirements of Section 254, the FCC, after consultation with the Federal-State Board on Universal Service, created a new Universal Service Fund in 1997 containing several distinct support mechanisms. As a result, total USF funding has grown from \$1.8

billion in 1997 to \$5.7 billion during 2002. While these support amounts are large, they must be kept in perspective. Total telecommunications revenues in the United States last year were in excess of \$220 billion. By annually collecting and redistributing less than 3% of these total revenues, we are able to make phone service affordable in all high-cost areas of the nation; support low-income customers; assist rural health care providers; and connect all classrooms to the internet. Moreover, all states and territories benefit from the USF as shown on Attachment 1 to my testimony. That's quite an accomplishment, and one that everyone involved in the USF should be proud of as we move forward to ensure the long-term sustainability of the fund.

III. The Funding Base Crisis

As I mentioned earlier, total funding for the USF has grown from \$1.8 billion to \$5.7 billion. Unfortunately, the funding base for the USF has not kept pace with the growth in the fund, resulting in higher and higher USF assessments on carriers and their customers. The problem stems in large part from the wording of the Act itself. Section 254(b)(4) states that: "All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." However, Section 254(d) states: "Every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and non-discriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service." In other words, even though the principle set forth

in the Act is that all telecommunications providers should contribute to the fund, and even though the fund benefits all areas of the country, Section 254(d) limits the obligation to support the fund to a subset of telecommunications carriers - providers of interstate telecommunications services.

In 1997 the FCC decided to base the funding for the high-cost and low-income support mechanisms on each carrier's interstate and international revenue, while the funding for schools and libraries and rural health support mechanisms were supported by assessments on all revenues, interstate and intrastate. The use of intrastate revenues for USF assessment purposes was struck down by the Fifth Circuit Court of Appeals in 1999. Since that time the contribution base for the USF has been limited to only interstate revenues. As the USF has grown in order to meet the Act's direction that support be sufficient and explicit, the assessment rate has also increased.

Attachment 2 to my testimony shows the change in USF funding since 1997, along with changes in the interstate revenue contribution base for the USF.¹ As you can see, the introduction of the schools and libraries fund and increases in the high-cost fund have driven the overall size of the fund. As a result, the fund has tripled, rising from

¹The interstate revenue base for a particular year generally represents revenues reported from the previous year. The USF assessment rate shown on Attachment 2 is not the actual rate used in any quarter, but is derived by dividing annual funding by the interstate revenue base. The interstate revenue base for years 1998 - 2002 comes from USAC reports. The interstate revenue base for 1997 is estimated. Full year data for 2002 assumes that the Fourth Quarter demand and revenue base will be the same as in the Third Quarter.

approximately \$1.8 billion in 1997 to approximately \$5.8 billion this year.² So long as interstate revenues grew at a reasonable rate, the ultimate impact of fund growth on the USF assessment rate and customers' bills was fairly moderate. However, beginning in 2000 interstate revenue growth began to flatten out and during 2002 started to decline. The result has been a steep escalation in the assessment rate, from 5.67% in the fourth quarter of 2000 to 7.28% in the second quarter of 2002. Without the FCC's actions of June 13, 2002, the assessment rate on providers would have risen to 8.77% beginning July 1. The impact on customers would have been even worse. Clearly, a universal service fund which cannot depend on its funding base is not predictable, is not sufficient, and is clearly not sustainable.

IV. Alternatives for the Contribution Base

There are several alternatives available in order to stabilize the USF contribution base. One alternative would be to remove the caps or safe harbor provisions in current rules which artificially depress the existing interstate revenue contribution base. However, I believe such actions would amount to short term band-aids which would not address the long term needs of the fund.

Another alternative would be to grant the FCC the authority to base contributions to

²The figures for this year do not take into account the actions taken by the FCC on June 13, 2002, to hold down the size of the fund by tapping unused schools and libraries funds.

the fund on total telecommunications revenues. While growth in the interstate revenue base has flattened out and begun to decline, total telecommunications revenues from end-users have continued to grow at a healthy pace. Shown on Attachment 3 to my testimony is a comparison of changes in the universal service fund, the interstate revenue base, and total telecommunications revenues from 1997 to 2002.³ As you can see, total telecommunications revenues would provide a healthy funding base for the USF. In fact, if total telecommunications revenues had been used as the funding base from the start, we would not be here today. The growth in the fund could have been accommodated while keeping the assessment rate below 3%.

Use of total revenues would also eliminate disputes about whether revenues are intrastate or interstate, and would equitably spread the obligation to support universal service to all providers and to all customers based on their use of the network. However, basing federal universal service on total revenues would require a statutory change to clarify that the FCC has the authority to base contributions on all revenues, intrastate as well as interstate. In addition, a total revenues base could be susceptible to erosion in the future as more and more traffic, including voice traffic, migrates to the internet and is classified as “information services” exempt from USF assessment.

³Total telecommunications revenues are taken from the FCC’s Telecommunications Industry Revenues reports. To be consistent with the interstate revenue base, reported revenues from a particular year are shown on the graph as the funding base for the next year. For example, the total reported revenues for 2000 of \$229.1 billion are shown on the graph as the funding base for 2001. Total revenues available for 2002 have not been reported. The funding base for 1997 is estimated.

A third alternative would be base assessments on connections to the public switched telephone network. The FCC is currently considering such a proposal. While the proposal does enlarge the base of the USF and open the opportunity for growth in the base in the future, it does have several flaws: (1) it radically shifts the funding of the USF among industry groups; (2) it appears to exempt a pure provider of interstate long distance from making any contribution to the fund in contravention of the plain wording of Section 254(d); and (3) it shifts responsibility for payment of USF charges from high-use to low-use customers. In spite of these flaws, the proposal does offer a promising avenue to avoid future problems with classification of services or revenues as information services, and deserves serious consideration.

IV. ISSUES RELATED TO PARTICULAR SUPPORT MECHANISMS

In looking at the long-term sustainability of the fund, we need to focus not only on the contribution base, but also on the individual support mechanisms which make up the overall fund. Each of these support mechanisms presents unique issues which will have to be resolved. Even though the focus of this hearing has been on stabilizing the fund - which implies that we should limit funding - we must be mindful that the Act requires the fund to be sufficient to carry out each of the universal service principles. For some mechanisms this may require a limitation in funding, while for others an expansion will be needed.

A. HIGH-COST SUPPORT

The high-cost support mechanism is the oldest portion of the fund, and is still the

biggest. High-cost support has grown by over \$1.2 billion in the last six years as the FCC has introduced three new parts to the fund: high-cost model support, interstate access support, and interstate common line support, which begins July 1. These new funds helped adapt the USF to the introduction of competition by making support explicit and portable. However, there is one issue common to all parts of the high-cost fund which threatens to enlarge the fund to an unsupportable size.

Under current rules, all lines provided by eligible telecommunications carriers (ETCs) in high-cost areas receive support. The support in any particular wire center is the same for all carriers, and is based on the costs of the incumbent carrier. Rather than competing for universal service support, all ETCs that provide service receive support in equal per line amounts. For example, a single family in a high-cost wire center could be provided two landlines by an incumbent ETC and three cellular lines by a wireless ETC. Each of these carriers would receive equal support for each of the lines provided. As a result, the potential exists for a large increase in the high-cost fund as more and more carriers, especially wireless carriers, attain ETC status. If the high-cost fund is meant to provide affordable access in all parts of the country, but not to subsidize the unlimited desires of each individual, then this issue will have to be dealt with in some manner.

B. LOW-INCOME SUPPORT

The FCC greatly expanded the eligibility criteria and the size of the low-income support mechanism in 1997. Nevertheless, the participation in the program varies widely among the states. As shown on Attachment 1, of the \$584 million paid out for low-income

support in 2001, over half went to one state, California. This is not to disparage California's low-income program, but to point out that low-income support funds are distributed very unevenly throughout the nation. There are also overall fund size implications from this skewed distribution. If every state's program was as successful as California's, the size of the low-income support fund would almost triple to \$1.5 billion. The FCC currently has a proceeding open to review the operation of the low-income support mechanism.

C. SCHOOLS AND LIBRARIES SUPPORT

The schools and libraries fund has been capped since its inception at \$2.25 billion. Demand for schools and libraries funds have always far exceeded the cap. As noted by the FCC in its Order of June 13, 2002, demand in the current year is almost double the funds available. As more and more schools have become connected to the internet through the e-rate, the demand for recurring or priority one funds has increased. The result has been that the money available for internal connections in the schools yet to be wired has been declining. The FCC's resolution of the unused funds issue its June 13, 2002, Order may help resolve this problem, but pressure on the cap is likely to continue. The FCC is also currently considering comments on reforms to the schools and libraries fund.

D. RURAL HEALTH CARE SUPPORT

Unlike the other support mechanism, the rural health fund has had difficulty generating sufficient demand. The FCC originally anticipated a \$100 million per year fund. However, in spite of repeated attempts to remake the fund, disbursements have remained

low, only \$7.9 million in 2001. Although the FCC is currently examining the operation of the rural health fund, the root cause of the problems for the rural health fund lie in the wording of Section 254. Unlike the schools and libraries support mechanism which provides discounts from regular prices on all telecommunications services, and pays for internal connections, Section 254(h) limits the rural health fund to the difference between rates available to health care providers in rural and urban areas of a state. Since many states have rural rates which are lower than urban rates, or have “postage stamp” rates for data services, the rural support mechanism has been of limited utility in meeting the needs of rural health providers. A statutory change should be considered which would make the rural health section of the Act parallel with the schools and libraries by providing services “at rates less than the amounts charged for similar services to other parties.”

V. CONCLUSION

In order to be sustainable in the long-term, the USF must be configured like a pyramid: it must have a broad and stable base of contributions at the bottom, and a narrow but sufficient focus of support at the top. The current universal service fund requires work on both ends: issues related to the contribution base must be resolved, and the limited resources of the fund must be properly targeted. In order to continue the public policy success of the universal service fund, we must support access, not excess.